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#193

DPS-3422
1 2

15 August 1958

Dear Dan:

1. This will reply to your letter DPS-1812, 25 June 1958, requesting comments relative to a pricing formula submitted by Pasadena, 7 August 1958. All data is based on the six-month period ended 31 July 1958.

2. Burden on Outside Processing, Material and Purchased Parts: The current book rate is 20%. Tests indicate that this rate should decrease, but not to the point where the annualized rate would be less than the proposed 14%.

3. Assembly and Shop Burden Rates: The current book rates are 96.0% and 168.9%, respectively; hence, the proposed 100% and 160% rates appear reasonable. (See paragraph 6, Comments.)

4. General and Administrative Expense Rate: The current book rate is 19.0%. (See paragraph 6, Comments.)

5. Direct Labor Rates:

a. The validity of the proposed rates was tested by reference to Payroll and Planning Department records. The proposed rates in the higher levels are approximately three cents an hour higher than actual and reflect wage increases anticipated in a new union contract. Inasmuch as the union negotiations will probably not be concluded before 31 December, direct labor costs will not include a raise, but the retroactive portion of the increase will be included in overhead. In this respect, it would appear that the contractor should have proposed actual labor rates and increased its overhead rates slightly to cope with the retroactive feature of the raise. However, I was reliably informed that fringe benefits in the new contract would be greater than the raise itself, and it appears that this factor was not considered when the proposed overhead rates were computed. This concept is not susceptible of an accounting determination, but it seems that the slightly higher labor rates will be offset by overhead rates greater than the proposed. Average labor rates in other classifications are slightly higher than proposed.

b. In testing labor charges to this contract, I discovered a situation which is always possible in fixed-rate contracts - that of a research mechanic (Proposed Grade I - $3.12) whose actual rate is $2.83, and a machinist specialist (Proposed Grade IV - $2.40) whose actual rate is $2.05. In another instance, a machine operator (Proposed Grade V - $2.15) was being paid at $2.29. In no single day, however, did labor of the last-mentioned type exceed labor in the first two categories. Little labor has been incurred to date, and the above test covered the most recent three days, 11, 12, and 13 August.

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6. Comments:

a. The contractor has again initiated a major accounting policy change, effective 1 August 1958. The change was necessitated by an unusual (at Pasadena) Navy contract award, and, of course, was ultimately approved by Navy Audit. The change eliminates material and purchased parts from the G&A base and results in higher G&A rates. However, if the ratio of project material and purchased parts to outside processing and subcontracting remains constant, the effect on this contract should be negligible. (For M&O and Field Service, serious consideration will have to be given.)

b. Two contracts, mentioned above, have been awarded by Navy. Material charges will approximate $1,200,000, and labor, burden, and G&A will approximate $1,300,000. This will have a definite impact on overhead and G&A rates, which I am unable to forecast, as information was not available as to performance periods.

Very truly yours,

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